
Note of RAWG meeting 18 November 2016

Present

Ofwat staff: Andrew Boardman, Rob Lee, Jenny Ngai, David Young, Mark Jones, Salim Lorgat

Industry attendees	
Phil Turner	Anglian Water
Richard Goodwin	Anglian Water
Jean Thomas	Welsh Water
Sarah Heath	United Utilities
Jon Latore	United Utilities
Mark Local	Northumbrian Water
Bally Matharu	Severn Trent Water
Eleanor Taylor	Severn Trent Water
Peter Hughes	Southern Water
Phil Newman	Southern Water
Lucy Aplin	Thames Water
Susan Thornton	Thames Water
David Peacock	Wessex Water
Tamar Robertson	Yorkshire Water
Tim Charlesworth	Affinity Water
Beverley Lawton	Bristol Water
Geraldine Redman	Bristol Water
Caroline Jemphrey	Portsmouth Water
Nicola Nestor	Portsmouth Water
Patrick Mallon	South East Water
Matt Hersey	South East Water
Philip Saynor	South Staffordshire Water
Beverley Heine	Sutton and East Surrey
Hannah Morrey	Tideway
Helen Smith	Tideway

Scope of meeting

We invited representatives from each company and covered the following areas:

- Recent developments
 - RAGs consultation to IN 16/09
 - Water2020
- Review of 2015-16 RAGs and general practical questions on compiling the financial tables in the APR
- RAG5 disclosures and transfer pricing
 - Review of 2015-16
 - Increased significance, especially with focus on tankered waste (sewage and sludge)
 - Potential for increased disclosures for non-appointed activities
- Cost assessment
 - General developments and timelines
 - more granular cost information for new price control units
- Cost of new connections
- Looking forward; 2017-18 and beyond
 - IFRS developments
 - Non-household retail

Key points from meeting

- Slide 5 - We published the 2016-17 RAGs on 31 October 2016 in IN 16/09.
- Slide 8 - Review of 2015-16 APR
 - Contracted out services for table 4D and 4E - Number of FTE's for contractors is not available, this is an issue for shared assets between contractors and so one method of allocation does not fit all situations, does the guidance need to be flexible? Can impact retail in particular for outsourced billing and/or call centres.
 - Allocation shifts many costs to retail and costs can move between water and wastewater.
 - High lift pumps - Need clear guidelines; pre-Accounting separation – Distribution, post-Accounting separation – Treatment? But guidance refers to 'pumps' only as part of the treatment process. Definition in cost tables is not specific, but logic (from the borehole example) would suggest that the decision to locate the pump is a distribution decision.
 - Costs are mainly for energy. Further discussion and clarification required from Ofwat (included in follow up questions).
 - Table 4E – One of the companies asked why we need to split foul, SWD, Highway drainage. We stated that this was because to have transparency of costs versus charges such as SWD. But accept that this is only for collection,

rather than treatment. Potential conflict with table 2A? **We agreed – line guidance should not have been changed for 2016-17, will revert to 2015-16 guidance, “should agree to table 2A”. Recharges will then be recognised within the upstream costs.**

- M&G Assets – The purpose of splitting principle use and recharging is to correctly charge the use of assets.
 - A company was unsure how recharges are treated outside totex. Why opex and capex are split on different basis. Totex will become mixed. We had a discussion around water and wastewater mix of non-operational assets. Under cost assessment principal use needs to be unwound to reflect use correctly.
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- Slides 9 and 10 – APR table 2E – One of the companies was unclear as to what is in the price control and how it will be treated at PR19. Another company stated that under the single till the other associated contributions for capital are netted off costs eg. fluoridation. Same for rental income from laboratory assets, income generated from regulatory assets. The question is do companies have a duty as a monopoly supplier? Is this income under price control? RAG4 appendix 1 provides guidance in this area. One of the companies asked if mains diversion contributions netted off costs is correct. We confirmed that the answer was yes.
 - Slide 15 - RAG5 principles – One of the companies asked if it is reasonable to add financing charge to transactions - which is not totex. We stated yes and should be added under RAG5 rules. A footnote to table could be added to explain what is included.
 - Slide 16 - RAG5 future developments - Trades on costed on LRMC basis will not be traded. Ofwat needs to facilitate trading and should be informed of any barriers. Ofwat needs to understand current actions and views of companies.
 - Slide 19 – IRE - One company stated IRE could still be used on the basis of renewals accounting under IFRS but others disagreed. Therefore a proxy calculation would need to be made for any continuity required for cost assessment purposes. Challenging to define under [now] different accounting treatments and capitalisation policies? E.g. Proactive renewals vs reactive repairs – will all need to be considered under any new definition since renewals accounting is now not allowed in UKGAAP.
 - Slides 25-34 – Costs of new connections - The government has stated that it has an ambition to deliver one million new homes by 2020 and as such it is anticipated that there will be a significant increase of activity in this area over the coming years. There are concerns over the current infrastructure charge in that it is not transparent and as such there is the potential for double charging for certain activities. Consideration was given as to the most appropriate format to collect the new information and it was decided that the incorporating the requirements into the existing APR was the best solution. The first year for which the new information will be required is the financial year 2017-18. A 5 year period for averaging is deemed reasonable for new development timescales.

During the discussion the following comments were made:

- One company asked if there was a definition of re-enforcement, but it was stated that this is to be defined once the boundary definitions are to be determined.
- One company suggested having a fixed charge which would apply to all companies. Currently there is a lot of “messaging about with no perceived benefit”.
- A developer does not decide to go for a development based on the infrastructure charge alone.
- One company noted that the infrastructure charge was previously split infra/non-infra.
- A company asked what the timeline was for incentives/penalties to be determined. No answer available at this stage.
- One company commented that the WFRIM meant that there were conflicting revenue and totex incentive mechanisms which didn't actively encouraged companies to promote the building of new houses.